May 19, 1999

__Greenspan Comments Undercut Kennedy Wage-Hike Efforts__

The Different Worlds of Greenspan and Kennedy

Senator Ted Kennedy and Alan Greenspan live in different economic worlds. Senator Kennedy's world upholds a legislated market as its paradigm; Alan Greenspan's takes a free market as its goal. These worlds don't just operate under different rules, but rather one's rules are a contradiction of the other's. Take minimum wage as one example.

Once again, Senator Kennedy wants to mandate an increase in the minimum wage — from $5.15 to $6.15 over three years. This seemingly insignificant increase in Senator Kennedy's world hides all manner of significant problems it creates in Alan Greenspan's. In Alan Greenspan's world of free markets, Senator Kennedy's proposal violates not only the principle by which wages are set, but is, in real terms, a sizeable increase. Furthermore, Senator Kennedy's proposal takes the creator of increased living standards in a free market — productivity — and turns it on its head so that it becomes a perverse barrier to economic opportunity for those on the bottom rung of the employment ladder.

Different Worlds: Legislated Markets vs. Free Markets

To Senator Kennedy, apparently nothing could be fairer than merely to legislate higher wages. This would explain why he seems to be pursuing this course on an annual basis (Congress increased the minimum wage by $1.00 over the two years of 1997 and 1998). In markets controlled by legislation, government fiat is not only acceptable, it is the requisite way by which supply and demand are set — as in the case of rationing or price controls.

The problem is that the government's determination of demand and supply does not necessarily — and in fact, does rarely, for any extended time — agree with society's determination. Society is dynamic; government is static. Without the ability for prices to continually change and thereby continually adjust supply to demand, inevitably there will be a mismatch. Such is the problem with the minimum wage.

In the real economic world, price — not government — is the regulator between supply and demand. When the price of a commodity rises, relatively less of it is demanded and relatively more of it is supplied. When the commodity is a person's labor, this law of supply and demand is no less true. Senator Kennedy's legislation artificially sets a minimum price for labor, a price which is at a higher level than that demanded for some individuals' labor. This is the case for those who have lower job-demanded skills — particularly the young and minorities. It is for this reason that despite an overall unemployment rate of just 4.3 percent, young people (age 16-19) and blacks have respective unemployment rates of 14.3 percent and 8.1 percent. And, among 16-19 year-old blacks, it's a distressing 33.9 percent [Bureau of Labor Statistics, April 1999].

A Mere Dollar More vs. Tripling Average Wage Growth

Senator Kennedy would argue that nothing was more trifling than requiring that the minimum wage be raised by $1 over three years within the overall scheme of an $8.7 trillion annual economy — what difference could an extra dollar over three years make? In the legislated economy of the Kennedy paradigm, government presumes it can define compassion and being able to define it, should therefore legislate it.

The problem is that the government's subjective determination of a wage hike does not meet with the objectively determined standards of productivity increases by which wages are actually set in the real economic world. Over any extended period of time, wages are determined by productivity — by how much is produced by a given quantity of input. As the ratio of output to input rises, so does wealth and therefore so do wages. Without an increase in productivity, there can be no increase in wealth. Yet, Senator Kennedy's proposal would require rewards in excess of what is being produced.

Senator Kennedy's $1 hike is actually a 19.4-percent increase over three years, or 6.5 percent annually. This is far above the overall wage increase. According to the Bureau of Labor Statistics, the average private industry wage paid by employers increased from $11.58 to $12.58 from 1992 to 1996— exactly matching Senator Kennedy's $1 dollar increase. However, this was just an 8.6-percent overall increase and just a 2.16-percent annual one — far smaller than what Senator Kennedy is proposing.

Further, Senator Kennedy's proposal to increase the minimum wage by a seemingly benign $1 per hour over three years masks the fact that it is outstripping recent or even any optimistic productivity increases. Let's look at productivity trends, and then compare the Kennedy wage hike proposal to the recent increases. Productivity is currently high compared to its historical rate: Following World War II, nonfarm productivity grew at 2.8-percent- annual-average rate; beginning in 1973 and for the next 20 years, it fell to a 1-percent rate. Of late, productivity has begun to grow at a higher rate: it increased 2.4 percent in 1998; 1.5 percent in 1997; and 2.7 percent in 1996. Incorporating 1999's extraordinary first quarter rate of 4 percent, the productivity growth rate over the last four quarters amounts to 3 percent.

So, for argument's sake, let's take that 3-percent figure, and add to it allowances for inflation: the Administration estimates inflation to be 2.3 percent over the next two years. That gets our three-year-productivity increase up to 5.3 percent. Yet, this is insufficient by over a full percentage point (5.3 percent versus Kennedy's 6.5 percent) to underwrite Senator Kennedy's proposal in the real economic world. Recall that without corresponding increases in productivity, the economy is damaged because it must pay for the wage hike by diverting its resources from elsewhere. Translated: even the recent very high productivity increases don't justify the relative enormity of the Kennedy proposal, and future ones aren't likely to be able to support it, either. And, recognize that this simple mathematical argument is premised on the questionable assumption that unskilled entry-level labor would somehow realize the same robust productivity increases as the skilled counterpart.

Effects of Productivity: Real Wealth Creator vs. Real Entry Barrier

To Senator Kennedy, productivity seems not to be an issue in his efforts to increase the minimum wage. However, in the real economic world, it is *the* issue in determining whether wages can really increase over a sustained period. By ignoring the fundamental factor of productivity, Senator Kennedy turns economics on its head. The perverse result is that Senator Kennedy's policy transforms productivity from its role of real wealth creator to being a real entry barrier to the lowest skilled workers — those workers most in need of entering the workforce.

Alan Greenspan, the chairman of the Federal Reserve, in a May 6, 1999 speech in Chicago, implicitly noted how potential productivity increases could be turned against the lowest skilled workers. Greenspan spoke of "yet unexploited profitable synergies," referring to an apparent enormous amount of yet-to-be-tapped productivity potential:

> "In recent years, businesses often have indicated a capability to dip into this backlog [of yet-to-be-tapped profitability] for capital investments that can quickly displace labor costs should they be perceived to rise. . . . Newer technologies and foreshortened lead times apparently have made capital investment distinctly more profitable, enabling firms to substitute capital for labor and other inputs far more productively than they could have a decade or two ago."

In short, Greenspan seems to see a situation of potential productivity increases that have not yet been tapped, but they will be tapped as soon as competitive forces — in the form of increasing price pressure and decreasing profit margins — justify it. And of course, Senator Kennedy's minimum wage hike would directly encourage businesses to tap "the backlog of these as yet unexploited profitable synergies" and make the "capital for labor" substitution that Greenspan foresees. The result: fewer jobs, particularly low-skilled jobs, than otherwise would have been created.

Result: Raising the Employment Ladder vs. Raising Real Wages

Despite Senator Kennedy's professed intentions of compassion, his proposed minimum-wage increase will have the opposite result for many actual and prospective minimum-wage workers — fewer job opportunities. Those minimum-wage workers, whose labor does not match the value of their mandated wage, can expect to be either shut out of or replaced in the labor market. The productivity that is the real wealth creator will *not* result in higher wages for some minimum-wage workers — as it will for tens of millions of other workers. Instead, it will be employed to lock them out, from these real wage gains, and even out of the labor market altogether. The culprit will be the mandated wage increase that requires compensation at an uneconomically justified rate. The culprit will be Senator Kennedy.

What is occurring in the minimum wage debate is a clashing between two worlds. In Senator Kennedy's economic world, compensation in the name of compassion can be legislated. In the real economic world, compensation comes from return — i.e., productivity, and real compassion is allowing the lowest skilled worker a chance to get into the job market. In the real economic world, increased worker productivity means increased wages. In the Kennedy economic world, untapped productivity has the potential to keep workers from entering the workforce altogether. Senator Kennedy's proposal will simply raise the first rung on the employment ladder to a level that the lowest skilled may never reach.

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